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In The

Supreme Court of the United States

MARC BRUH,

Petitioner,

v.

BESSEMER VENTURE PARTNERS III L.P. and VISTACARE, INC.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the decision of the Second Circuit Court of Appeals below, which was predicated on the Securities and Exchange Commission's ("SEC") interpretation of Rule 16b-7, 17 C.F.R. §240.16b-7 (1991), conflicts with a prior decision of the Third Circuit Court of Appeals, where the SEC advanced the same interpretation to the Third Circuit in an *amicus* brief filed in support of the defendants' petition for rehearing, which the Third Circuit in a panel and an *en banc* vote nonetheless denied?

2. Whether the SEC's proposed interpretation of Rule 16b-7 is entitled to binding deference where it is contrary to the plain language of the rule and other objective indicia of its intended meaning at the time of its adoption and where the SEC lacks enforcement authority over the underlying statute?

3. Whether an agency is entitled to deference in defining an undefined regulatory term in a manner inconsistent with the general understanding of that term's meaning?

4. Whether an exemption for essentially all reclassifications, including those that provide the potential for speculative abuse, exceeds the SEC's statutory exemptive authority where the plain language of the statute evidences Congressional intent to subject such transactions to Section 16(b) liability?

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OPINION BELOW

The opinion of the court of appeals, (App. 1-24),[1] is reported at 464 F.3d 202. The opinion of the district court is unreported but available at 2005 U.S. Dist. LEXIS 18543 (App. 25-38).

JURISDICTION

The court of appeals issued its decision and judgment on September 13, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS AND REGULATORY PROVISIONS INVOLVED

This case arises under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78p(b) (2006) ("Section 16(b)") and primarily involves Rule 16b-7 as promulgated by the Securities and Exchange Commission ("SEC" or the "Commission") in 1991, 17 C.F.R. §240.16b-7 (1991) and an amended version of Rule 16b-7 ("Amended 16b-7") promulgated by the SEC in August 2005, 17 C.F.R. §240.16b-7 (2006). The provisions of the statute and the rules are lengthy and are reproduced in full in the Appendix. (App. 45-50).

[1] Documents reproduced in the Appendix to this petition will hereinafter be referenced as ("App. ___").

I. STATEMENT OF THE CASE

A. The Nature of The Case

This action arises under Section 16(b) and is brought on behalf of VistaCare, Inc. ("VistaCare" or the "Company") by Marc Bruh, a shareholder of VistaCare. Plaintiff-petitioner alleges that defendant Bessemer Venture Partners III L.P. ("Bessemer" or "Respondent"), realized profits through short-swing purchases and sales of VistaCare common stock ("Common Stock") at times when Respondent was a statutory insider for purposes of Section 16(b).

B. Statement of Facts

Bessemer was a large outside investor in VistaCare and in that capacity had access to inside information concerning VistaCare's operations. Bessemer's investment in VistaCare took two different forms: (i) Common Stock; and (ii) Series A-1 Preferred Stock ("Preferred Stock"). The Preferred Stock was not convertible into Common Stock. However, as a consequence of arm's-length negotiations between VistaCare and Bessemer, the certificate of incorporation was amended to provide that in the event of a qualified initial public offering ("IPO") of VistaCare stock, the Preferred Stock was to be automatically converted to Common Stock at the IPO price. *Bruh*, 464 F.3d at 205 n.3 (App. 3).

The IPO price of $12.00 was set on December 17, 2002, six days prior to the IPO. Also, on December 23, 2002, at the close of the IPO, the Preferred Stock was converted pursuant to VistaCare and Bessemer's agreed-upon conversion formula with Bessemer receiving 251,865 shares of Common Stock. On December 23, 2002, the

Common Stock opened for trading on the stock market at $15.90 per share. On May 13, 2003, Bessemer sold 1,228,679 shares of Common Stock in a secondary offering for a net sales price of $18.95 per share allowing Bessemer to realize short-swing profits in excess of $1.7 million. *Bruh*, 464 F.3d at 205 (App. 4).

C. Proceedings in the District Court

On September 18, 2003, Bruh filed suit in the United States District Court for the Southern District of New York. On August 26, 2005, following completion of pre-trial discovery, Judge George B. Daniels issued an Opinion denying Bruh's motion for summary judgment and granting Bessemer's motion for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. On August 30, 2005, a Judgment was entered dismissing the action in its entirety.

D. Proceedings in the Court of Appeals

Petitioner filed a Notice of Appeal on October 3, 2005 and timely filed his opening brief on January 6, 2006. Oral argument was heard on April 7, 2006. Prior to oral argument, the SEC wrote the Circuit Court stating that the Commission might wish to participate in the case through filing a brief *amicus curiae*. (App. 39).

On April 19, 2006, the Circuit Court issued an Order instructing the SEC to address the following three issues:

> (1) whether the parties' establishment of a conversion agreement in 1999 constituted a "purchase" within the meaning of Section 16(b) of the Securities [] Exchange Act of 1934; (2) whether

> the conversion of preferred stock into common stock was a "reclassification" within the meaning of SEC Rule 16b-7, 17 C.F.R. §240.16b-7; and (3) whether recent amendments to Rule 16b-7 are permissibly retroactive.

(App. 39-40).

On May 12, 2006, the SEC filed its *amicus* brief (hereinafter the "SEC *Amicus* Brief") answering the Circuit Court's questions as follows: (1) the 1999 conversion agreement was not a purchase but, instead, the purchase took place with the setting of a conversion price for the Preferred Stock on December 17, 2002; (2) the conversion was a reclassification within the meaning of Rule 16b-7; and (3) Amended Rule 16b-7 was permissibly retroactive. Based on these answers, the SEC opined that the District Court decision should be affirmed but on a different basis than that which the District Court had ruled.[2]

On September 13, 2006, the Circuit Court issued a decision affirming the District Court's granting summary judgment to Defendant and holding that Bessemer's purchase of Common Stock was exempt under Rule 16b-7. The Circuit Court declined to reach the issue of whether Amended 16b-7 was impermissibly retroactive.

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[2] *See* Brief of the Securities Exchange Commission, *Amicus Curiae*, Submitted at the Request of the Court and in Support of Affirming the Decision Below (filed May 12, 2006) *available at* http://www.sec.gov/litigation/briefs/bruhbrief.pdf. Petitioner will be pleased to lodge a copy of the brief or any other document referenced in this petition at the request of the Court.

II. SUMMARY OF REASONS FOR GRANTING THE PETITION

This case involves important issues relating to the limits of agency deference which have resulted in a conflict between the Second Circuit and the Third Circuit in interpreting Rule 16b-7 and the statutory intent of Section 16(b). The Circuit Court, in reaching a decision contrary to that of the Third Circuit, failed to take account of this Court's precedents restricting deference to an agency's interpretation of its own regulations where standard devices of judicial construction demonstrate an interpretation contrary to that proffered by the agency and where the agency in question lacks enforcement authority over the underlying statutory scheme. Similarly, in deferring to the Commission's interpretation of the intent and purpose of Section 16(b), the Circuit Court failed to take proper account of this Court's decisions restricting the scope of such deference where the purpose of the statute is clear from its language and legislative history.

III. REASONS FOR GRANTING THE PETITION

A. The Circuit Court's Decision Conflicts With a Third Circuit Decision on the Important Matter of the Correct Interpretation of Rule 16b-7 and its Consistency with the Purpose of Section 16(b)

The Third Circuit Court of Appeals ruled on the scope of reclassifications exempted by Rule 16b-7. *See Levy v. Sterling Holding Co.*, 314 F. 3d 106, 114-17 (3d Cir. 2002). The Circuit Court in interpreting the same rule acknowledged that its decision conflicts with that of the Third Circuit in *Levy*. *See Bruh*, 464 F.3d at 212-13 (App. 20).

The Circuit Court attributed this conflict to its having the SEC's views with respect to the correct interpretation of Rule 16b-7 as expressed in an *amicus* brief, something which the Third Circuit lacked in deciding *Levy*. *See Bruh*, 464 F.3d at 212-13 (App. 20-21). However, this is not an accurate portrayal of the facts. In reality, following the Third Circuit's decision in *Levy*, the SEC filed an *amicus* brief supporting the defendants' petition for rehearing and/or rehearing *en banc*. *See* Memorandum of the Securities and Exchange Commission, *Amicus Curiae*, In Support of Appellee's Petition for Rehearing or Rehearing *En Banc* (filed Feb. 27, 2003) ("*Levy Amicus* Brief").[3]

In an Order dated April 30, 2003, the Third Circuit rejected the petitions for rehearing both in a vote of the Third Circuit Panel and the entire Court sitting *en banc*. (App. 43-44). In doing so, as in declining to seek an *amicus* brief from the SEC prior to its original decision,[4] the Third Circuit concluded that further guidance from the SEC was unnecessary and, that as demonstrated below, the language and regulatory history of Rule 16b-7 did not extend a blanket exemption for reclassifications as advocated by the Commission. *See Levy*, 314 F.3d at 114.

Notwithstanding the decision in *Levy*, the SEC continued to opine that Rule 16b-7 exempted *all* reclassifications. In order to further its position, the SEC in August 2005 adopted Amended 16b-7(a), which is identical to the interpretation of Rule 16b-7 advanced by the SEC in *Levy*

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[3] A copy of the *Levy Amicus* Brief is available at http://www.sec.gov/litigation/briefs/levy-sterling022703.htm.

[4] *Compare Schnall v. Amboy Nat'l Bank*, 279 F.3d 205, 207 (3d Cir. 2002) (requesting an *amicus* submission from the Federal Reserve Board of Governors concerning compliance with agency regulations).

for the first time. That interpretation seeks to exempt reclassifications based upon the following test:

> the acquisition of a security of a company, pursuant to a . . . reclassification . . . in exchange for a security of a company that before the . . . reclassification . . . owned 85 percent of either: (i) [t]he equity securities of all other companies involved in the . . . reclassification . . . ; or (ii) [t]he combined assets of all the companies involved in the . . . reclassifications. . . .

17 C.F.R. §240.16b-7(a).

In a reclassification, the securities received are ***always*** of a company that owned 85% of the assets of the companies involved. Thus, Amended 16b-7 effectively exempts *all* reclassifications. *Accord, Levy*, 314 F.3d at 114 (same interpretations advocated by the Appellees would effectively result in an exemption for all reclassifications.).

Bruh suggests in a footnote that there may not be any conflict with *Levy* based upon factual differences in the timing of the amendments to the certificates of incorporation causing the reclassifications. *See Bruh*, 464 F.3d at 213 n.12 (App. 20). However, the timing of the charter amendment is not part of any SEC test or rationale for its newly stated views on reclassifications. *See Ownership Reports and Trading by Officers, Directors, and Principal Security Holders*, 70 Fed. Reg. 46080, 46081 (Aug. 9, 2005) ("2005 SEC Release") (Amended 16b-7 was adopted for the express purpose of overruling *Levy*). Moreover, this distinction lacks any significance in light of the SEC's position that these acquisitions took place when the conversion price was fixed. Thus, the timing of the

charter amendments is irrelevant. *See* SEC *Amicus* Brief at 4.

The Third Circuit also held that such a blanket exemption was inconsistent with the statutory purpose of Section 16(b). *See Levy*, 314 F.3d at 117-18. The Circuit Court, in adopting the SEC's position, also disagreed with the Third Circuit on that issue. *Bruh*, 464 F.3d at 212-13 (App. 20).

B. Deferring to the SEC's Plainly Erroneous Interpretation of Rule 16b-7 is Inconsistent With This Court's Decisions Limiting the Scope of Agency Deference

The Circuit Court's decision was based on its deference to the SEC's interpretation of Rule 16b-7. *Bruh*, 464 F.3d at 210-11 (App. 14-17). However, such deference is inconsistent with this Court's decisions on the scope of deference afforded to an agency's interpretation of its own regulations because: (a) the Commission's proposed interpretation does not conform to the text of the rule, the regulatory history, or other indicia of the rule's objective meaning; (b) given that the SEC lacks enforcement authority with respect to Section 16(b), there can be no implied delegation of authority to interpret Rule 16b-7; and (c) even assuming *arguendo* that Rule 16b-7 exempted reclassifications, as a consequence of the term's inclusion in the title of the rule, the nature of the exemption and its applicability is so unclear that the SEC's subsequent views concerning the exemption may not be granted deference.

1. Deference is Inappropriate Because the Intent of Rule 16b-7 at the Time it was Promulgated Can be Determined by Objective Criteria

Deference to agency interpretations is appropriate "only when the devices of judicial construction have been tried and found to yield no clear sense of . . . intent." *Gen. Dynamics Land Sys. v. Cline*, 540 U.S. 581, 601 (2004) (citing *INS v. Cardoza-Fonseca*, 480 U.S. 421, 446-48 (1987); *Chevron v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 n.9 (1984)). These devices of judicial construction are "the regulation's plain language" and "other indications of . . . intent ***at the time of the regulation's promulgation***." *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994) (emphasis added). *Accord*, *Thomas Jefferson*, 512 U.S. at 520 (Thomas, J., dissenting) ("deference is not abdication, and it requires us to accept only those agency interpretations that are reasonable in light of the principles of construction courts normally employ.") (quoting *EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 260 (1991) (Scalia, J., concurring in part and concurring in judgment)).

a. The Plain Language of Rule 16b-7 Demonstrates That the SEC's Interpretation of Rule 16b-7 is Plainly Erroneous

Here, as demonstrated above (*see* Point II, *supra*), the plain language of Rule 16b-7(a) is directly contrary to the SEC interpretation adopted by the Circuit Court. Rule 16b-7, as adopted by the SEC in 1991, did ***not*** contain the word "reclassifications" in the text of the rule. Instead, the rule's text only mentioned "mergers" and "consolidations." *See* 17 C.F.R. §240.16b-7 (1991) (App. 45-46). *Accord,*

Bruh, 464 F.3d at 210 (App. 14); 2005 SEC Release, 70 Fed. Reg. at 46084.

Those terms have well-understood common law meanings. Thus, a leading corporate law treatise explains that:

> [C]onsolidation . . . has a definite legal meaning when it is accurately used. It is a combination by agreement between two or more corporations of the same or different states, and under authority of the law, by which their rights, franchises, privileges and property are united, and become the rights, franchises, privileges and property of a single corporation, composed generally, although not necessarily, of the shareholders for the corporation.
>
> * * *
>
> The term "merger" in connection with corporations also has a distinct meaning . . . Like the latter, it is permissibly used to denote various arrangements by which two or more corporations become united in interest. Strictly speaking, a merger means the absorption of one corporation by another; the latter retains its name and corporate identity with added capital, franchises and powers of the merged corporation.

15 *Fletchers Cyclopedia of Corporations* §7041 at 8-12 (1999). *Accord*, 8 Del. C. §251(a) ("2 or more corporations . . . merge into a single corporation, which may be any 1 of the constituent corporations or may consolidate into a new corporation. . . . ").

Neither of these terms encompass a reclassification which involves changing the terms of the securities issued by a *single corporation* rather than the interests of two

distinct corporations each having a separate legal existence prior to their merger or consolidation. *Accord*, 8 Del. C. §242(a)(3). Therefore, Rule 16b-7 as adopted in 1991 was not ambiguous. *Cf.*, *Nat'l R.R. Passenger Corp. v. Boston & Maine Corp.*, 503 U.S. 407, 418 (1992) ("alternative dictionary definitions . . . each making some sense under the statute" indicates that a statute is ambiguous).

Indeed, the Circuit Court did not base its interpretation of Rule 16b-7 on any word in the text of the rule. Instead, the Circuit Court looked to the title of Rule 16b-7 containing the word "reclassifications." *Bruh*, 464 F.3d at 210 (App. 14). However, it is settled law that the heading of a statute (or regulation) is not utilized in interpreting the plain meaning of a statute and can only be used to "shed light on some ambiguous word or phrase in the statute itself." *Whitman v. American Trucking Ass'n*, 531 U.S. 457, 483 (2001) (quoting *Carter v. U.S.*, 530 U.S. 255, 267 (2000)).

Therefore, since the terms "mergers" and "consolidations" are not ambiguous, it was improper and inconsistent with this Court's precedents for the Circuit Court to reference any other source to determine the correct meaning of Rule 16b-7. *See, e.g.*, *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 119 (2001) (citing *Ratzlaf v. U.S.*, 510 U.S. 135, 147-48 (1994) (courts "do not resort to the legislative history to cloud a statutory text that is clear.")). Instead, the Circuit Court's analysis should have ended with the language of the rule and concluded that Rule 16b-7 does *not* provide an exemption for reclassifications. *Accord*, *Roberto v. Dep't of the Navy*, 440 F.3d 1341, 1350 (Fed. Cir. 2006) (where "the plain meaning of the regulation is clear, no further inquiry is required into agency interpretations or the regulatory history to determine its

meaning.") (citing *Meeks v. West*, 216 F.3d 1363, 1366 (Fed. Cir. 2000)).

Indeed, recognizing that Rule 16b-7 did not have the meaning first advocated by the Commission in connection with *Levy*, the SEC in August 2005 adopted Amended 16b-7, an entirely new regulation with different terms than Rule 16b-7. *Compare* Rule 16b-7 (App. 45-46) *with* Amended 16b-7 (App. 47-48).

This Court has specifically prohibited deference in these circumstances. "To defer to the agency's position would be to permit the agency, under the guise of interpreting a regulation, to create *de facto* a new regulation." *Christensen v. Harris County*, 529 U.S. 576, 588 (2000). Here, *a fortiori*, Amended 16b-7, which embodies the SEC's 2005 interpretation of Rule 16b-7, is not only a *de facto* new interpretation but also is a *de jure* new rule because the substance of the regulation has been changed. Such conduct is not entitled to deference.[5]

b. Other Indicia of the SEC's Contemporaneous Intent in Adopting Rule 16b-7 are Equally Clear

Rule 16b-7 was first adopted by the SEC in 1952. *See Exemption of Certain Transactions from Section 16(b)*, Exchange Act Release No. 4717, 17 Fed. Reg. 5501 (June

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[5] A new rule could only be applied to this case if Congress had expressly authorized the SEC to promulgate rules having a retroactive effect with respect to Section 16(b). *See, e.g., Bowen v. Georgetown Univ. Hospital*, 488 U.S. 204, 208 (1988). No such delegation of authority was made to the SEC, making application of Amended 16b-7 to this action inconsistent with this Court's precedents.

19, 1952 and corrected July 18, 1952 at 17 Fed. Reg. 6579); *see also Bruh*, 464 F. 3d at 210 (App. 15). The rule remained unchanged from that time until 1991 when the SEC added the word "reclassifications" to Rule 16b-7's heading without changing the text of the rule. *See Ownership Reports and Trading By Officers, Directors and Principal Security Holders,* Exchange Act Release 28869, 56 Fed. Reg. 7242, 7273 (Feb. 21, 1991) ("1991 SEC Release"); *see also Bruh*, 464 F.3d at 212 (App. 18).

However, the 1991 change in the title of Rule 16b-7 was intended to have "no substantive change" to the law. *See* 2005 SEC Release, 70 Fed. Reg. at 46084 & n.61 (citing 1991 SEC Release, 56 Fed. Reg. at 7261-62). This means that any such exemption must have pre-dated the 1991 SEC Release.

The SEC, recognizing the barrier this pellucid piece of regulatory history posed to its proposed interpretation of Rule 16b-7, asserted that reclassifications have been exempt since the time Rule 16b-7 was first adopted in 1952. *See* SEC *Amicus* Brief at 10; 2005 SEC Release, 70 Fed. Reg. at 46084. That claim, however, can not withstand serious scrutiny. There was no mention of reclassifications in the text of Rule 16b-7 as adopted by the SEC in 1952 or in any of the contemporaneous regulatory history (*see generally*, 17 Fed. Reg. 5501) and when given the opportunity the SEC refused to inform anyone of this purported opinion.

Specifically, shortly after the adoption of Rule 16b-7, the Second Circuit, in *Roberts v. Eaton*, 212 F.2d 82 (2d Cir. 1954), addressed the circumstances under which reclassifications are exempt from Section 16(b) liability. In connection with its deliberations, the Second Circuit

invited the SEC to opine as to when reclassifications should be exempt from liability – ***an invitation which the SEC declined to accept***. *Id.* at 84. It is entirely irrational to accept that the SEC believed Rule 16b-7 applied to exempt reclassifications, particularly in the manner currently asserted, but refused to tell anybody, even the Second Circuit.

Both the SEC and the Circuit Court ignore these facts demonstrating that the SEC lacked any intent contemporaneous with the adoption of Rule 16b-7 to exempt all reclassifications.[6] Instead, the Circuit Court relied primarily on a 1981 interpretive release by the SEC discussing Rule 16b-7. *See Bruh*, 464 F.3d at 210-11 (App. 15-17) (citing *Interpretive Release on Rules Applicable to Insider Reporting and Trading*, Exchange Act Release No. 34-18114, 46 Fed. Reg. 48147 (Sept. 24, 1981) (the "1981 SEC Release")).

However, the 1981 SEC Release could not have caused any change in the law because the 1981 SEC Release was only a series of "staff interpretations." 1981 SEC Release, 46 Fed. Reg. at 48147. Such staff interpretations, even if published in a compendium form by the Commission, do not constitute "rules and regulations," which are the only means through which the SEC has statutory authority to act with respect to Section 16(b). *See* 15 U.S.C. §78p(b); *accord*, *Gollust v. Mendell*, 501 U.S. 115, 122 (1991).[7]

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[6] *See* Point I, *infra* explaining why the SEC's new interpretation of Rule 16b-7 exempts all reclassifications.

[7] Indeed, the SEC has acknowledged that "interpretive letters are not official expressions of the Commission's views and do not have the force of law." Brief of the Securities and Exchange Commission, *Amicus Curiae*, in Support of Appellant and Issues Addressed, *Morales v.*

(Continued on following page)

Moreover, even assuming *arguendo* that the 1981 SEC Release had the force of law – which under controlling principles of law it could not – all it said was that "Rule 16b-7(a) *can* apply to transactions involving reclassifications." 1981 SEC Release, 46 Fed. Reg. at 48177 (emphasis added). That language cannot bear the burden of the interpretation the Circuit Court has placed upon its shoulders.

Through use of the word "can," the rule – assuming *arguendo* it applied to reclassifications – would at most be permissive. *See Alloc, Inc. v. ITC*, 342 F.3d 1361, 1378 (Fed. Cir. 2003); *Central States Motor Freight Bureau, Inc., v. ICC*, 924 F.2d 1099, 1105 (D.C. Cir. 1991). Thus, as phrased, the 1981 SEC Release states only that where a merger or consolidation which otherwise falls within the ambit of Rule 16b-7(a) *also involves a reclassification*, the exemption *may* still apply. In that regard, it is particularly telling that Question 142 of the 1981 SEC Release, within which the SEC's statement concerning reclassifications is contained, analyzes a series of hypothetical factual scenarios, none of which implicates a pure reclassification existing outside the context of a merger or a consolidation. *See Levy,* 314 F.3d at 114 (noting that "the illustrated examples contained in Question 142 of the release do not discuss reclassifications."). In fact, no one believed that reclassifications were exempt by virtue of Rule 16b-7. Thus, a comprehensive survey of Section 16(b) undertaken by a task force of the American Bar Association Committee on Federal Regulation of Securities, makes only one

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Quintel Entertainment, Inc., 99-9374 (2d Cir.) at p.15 n.9 (citing *New York City Employees' Retirement Sys. v. Securities and Exchange Comm'n*, 45 F.3d 7, 12-13 (2d Cir. 1995)).

mention of a possible exemption for reclassifications, and that is in the context of the unorthodox transaction doctrine. *See Report of the Task Force on Regulation of Insider Trading – Part II: Reform of Section 16*, 42 Bus. Law. 1087, 1115 (August 1987) (the "Task Force Report"). ***The Task Force Report makes no mention of reclassifications being exempt under Rule 16b-7.***

The Task Force Report is consistent with the Third Circuit's decision in *Levy* that reclassifications are exempt from Section 16(b) liability only where there is: (1) no change in the proportional equity interest; and (2) no change in the investment opportunities and downside risks associated in holding the different securities. *See Levy*, 314 F.3d at 117. It is also consistent with the SEC limiting any statements of no-action[8] for reclassifications to transactions involving "technical rather than substantial changes in the affected securities." *Xidex Corp.*, 1985 SEC No-Act. LEXIS 1855 at *1 (Mar. 7, 1985).[9]

Indeed, every case addressing the availability of an exemption for reclassifications under Section 16(b) prior to *Levy* reached the same conclusion. Thus, *Roberts v. Eaton*,

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[8] The term "no-action" is technically inaccurate because the SEC lacks enforcement authority with respect to Section 16(b). *See Levy*, 314 F.3d at 116 n.6.

[9] Such technical changes include: changes from corporate to trust form (*Weingarten Realty Co.*, 1988 SEC No-Act. LEXIS 61 (Jan. 22, 1988); changes from limited partnership to corporate form (*St. Charles Acquisition, L.P.*, SEC No-Act. Letter, 1992 WL 146563 (June 25, 1992)); a spin-off of shares of another issuer held in the issuer's portfolio (*e.g.*, *Capital Properties*, 1987 SEC No-Act. LEXIS 2409 (Sept. 14, 1987); a split-off of one of the issuer's businesses (*United States Steel*, 2001 SEC No-Act. LEXIS 853 (Dec. 28, 2001)); and a split-up of the issuer into two independent public companies (*U.S. Steel, supra*).

supra, the seminal case for addressing liability for reclassifications under Section 16(b), limited any exemption from liability to situations where "the two types of stock were virtual economic equivalents." *Newmark v. RKO General, Inc.*, 294 F. Supp. 358, 362 (S.D.N.Y. 1968), *aff'd*, 425 F.2d 348 (2d Cir. 1970).[10] Indeed, the SEC acknowledged that this was a limitation of the *Roberts* holding. *See Levy Amicus* Brief at 10 ("These cases often involved the drawing of fine distinctions, turning on such matters as whether the insiders' proportional investment in the company changed. . . . ").

The SEC also acknowledged that its current interpretation of Rule 16b-7 conflicts with the approach taken by courts, including the Second Circuit. *See Levy Amicus* Brief at 10. However, no such statement of purpose is found anywhere in the regulatory record stating that it was the SEC's intent in 1952, 1981 or 1991, to overrule existing law. *Cf.*, 1991 SEC Release, 56 Fed. Reg. at 7250 & nn.116, 117 (stating that newly adopted rules were inconsistent with previously existing precedents). This demonstrates that, in fact, the SEC had no such contemporaneous intent. *Accord*, *Hillsborough v. Automated Med. Lab., Inc.*, 471 U.S. 707, 718 (1985) (agencies must make clear any intention to displace existing law).

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[10] *Rothenberg v. United Brands Co.*, 1977 U.S. Dist. LEXIS 15937 (S.D.N.Y. 1977) and *Hayes v. Sampson*, 1980 WL 1460 (S.D.N.Y. 1980), cited by the Commission (*see* SEC *Amicus* Brief at 9) are not to the contrary. As the Ninth Circuit subsequently ruled, "*Rothenberg* and *Hayes* stand for the proposition that a recapitalization which results in a change in the nature of a beneficial owner's investment and market risk is a sale within section 16(b)." *Colan v. Mesa Petroleum Co.*, 951 F.2d 1512, 1525 (9th Cir. 1991).

Finally, the Circuit Court relied on a 2002 SEC release stating that "[a]cquisitions or dispositions pursuant to holding company formations and similar corporate reclassifications and consolidations" are exempt from reporting on the ground that "[t]hese are the transactions exempted from Section 16(b) short-swing profit recovery by Exchange Act Rule 16b-7." *Bruh*, 464 F.3d at 212 (App. 19) (citing *Form 8-K Disclosure of Certain Management Transactions*, 67 Fed. Reg. 19914, 19919 & n.56 (Apr. 23, 2002)). Aside from this release not being contemporaneous with Rule 16b-7's promulgation, forming a holding company leaves a shareholder's proportionate interest in the entity unchanged and falls under the category of mere technical changes which have always been understood to be exempt. *See Xidex Corp.*, *supra*. All that happens is that securities in an operating company are swapped for those in a holding company while all shareholders maintain their proportionate equity interest in the enterprise. The same is true of the portion of the 1981 SEC Release quoted at length by the Circuit Court discussing a statutory exchange. *See Bruh*, 464 F.3d at 211 (App. 15-17) (quoting 1981 SEC Release, 47 Fed. Reg. at 48177). That hypothetical transaction involved the formation of a holding company in which the proportionate equity interests of all shareholders remained the same after the transaction. Here, in contrast (and as in *Levy* and many other reclassifications), the proportionate interests of shareholders did *not* remain the same making the example quoted by the Circuit Court irrelevant to the proper analysis of the issues in dispute in this action.

2. The Circuit Court Erred in Granting Deference to the SEC's Interpretation Because the SEC Lacks Enforcement Authority With Respect to Section 16(b)

An important and somewhat unusual fact of this case is that the SEC's only delegated authority with respect to Section 16(b) is to promulgate rules and regulations exempting certain transactions from liability. *See* 15 U.S.C. §78p(b). In contrast to the traditional unitary agency model, Congress declined to allow the SEC the right to either enforce or adjudicate any Section 16(b) claims. *See, e.g., Gollust*, 501 U.S. at 122.

Martin v. OSHRC, 499 U.S. 144, 151 (1991), the leading case which the Circuit Court relied upon in holding that it was required to defer to the SEC's interpretation of Rule 16b-7 (*Bruh*, 464 F.3d at 208 (App. 10)), is not on point. *Martin* limited its implication of authority to those agencies which are also charged with responsibility for enforcing the regulations. *Id.* at 152. *Accord, U.S. v. Mead*, 533 U.S. 218, 228 (2001) (the fair measure of deference is "understood to vary with circumstances.").

Here, the SEC lacks any such enforcement authority. Therefore, the Commission's interpretation of a regulation issued pursuant to Section 16(b) is not entitled to deference. *Accord, Gonzales v. Oregon,*__ U.S. ___, 126 S. Ct. 904, 915 (2006) (deference is premised on the particular agency being "charged with enforcing" the underlying regulations.); *Native Am. Arts, Inc. v. Waldron Corp.*, 399 F.3d 871, 874 (7th Cir. 2005) (no deference to agency interpretation due "since the Board's enforcement role is extremely limited"). *See also* Note, *Congressional Intent and Deference to Agency Interpretations of Regulations*, 66 U. Chi. L. Rev. 134, 1353 (1999) (deference to an agency

interpretation of its own regulations can only be justified as a means for courts to follow congressional intent – delegation of interpretive power to agencies.) (citing Justice Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 Duke L. J. 511 (1989)).

3. Granting Deference is Inappropriate Because it Allows the Statutory Goals of the Administrative Procedure Act to be Violated

The Administrative Procedure Act ("APA"), 5 U.S.C. §551 *et seq.*, prohibits federal agencies from enacting entirely vague regulations and then giving them content at will through interpretive releases. *See Paralyzed Veterans of America v. Arena, L.P.*, 117 F.3d 579, 584 (D.C. Cir. 1997). "It is certainly not open to an agency to promulgate mush and then give it concrete form only through subsequent less formal 'interpretations.'" *Id.*[11] Here, even assuming *arguendo* that the term "reclassifications" in the title of Rule 16b-7 is deemed to be a part of the rule, it is, Petitioners respectfully submit, the very embodiment of "mush" as it says absolutely nothing about the circumstances under which reclassifications are to be exempt. It is axiomatic, therefore, that such a "rule" is undeserving of deference. *Accord, Goldman v. Hartford Life & Accident Ins. Co.*, 417 F. Supp. 2d 788, 804 (E.D. La. 2005) (no

[11] The APA also requires "notice and comment" prior to adopting a legislative rule. *See* 5 U.S.C. §553. Thus, to the extent the 1991 addition of the word "reclassification" to the title of the rule can be deemed a substantive rule change, it violated the APA as no effective notice was provided of what the SEC intended to accomplish.

deference where the rule "simply does not speak to the issue") (citing *Gonzales*, *supra*).

C. The Circuit Court's Deference to the SEC's Proposed Interpretation of the Term "Reclassifications" is Also Contrary to This Court's Precedents

In this case, a reclassification under Delaware law, the State of VistaCare's incorporation, could only take place where two-thirds vote of the Preferred Stock acting as a separate class votes in favor of the transaction. *See* 8 Del. C. §242(b)(2).[12] Absent a specific regulatory definition of "reclassification," that term should be assigned its generally understood meaning. *See*, *e.g.*, *Carter v. U.S.*, 530 U.S. 255, 264 (2000).

Here, no such vote of the holders of the Preferred Stock took place in connection with the transaction in which Bessemer acquired Common Stock. Therefore, a reclassification, under Delaware law and the term's generally understood meaning, does not encompass the transaction at issue in this case.

Nonetheless, the Circuit Court adopted the SEC's argument that the transaction qualified as a "classic reclassification." *See Bruh*, 464 F.3d at 208-09 (App. 12). However, such classic reclassifications are a phantasm. Elsewhere in the federal securities laws, the SEC, in defining reclassifications, has explicitly looked to the "statutory provisions of the jurisdiction under which such

[12] There was a similar requirement contained in VistaCare's Third Amended and Restated Certificate of Incorporation.

corporation or other person is organized. . . . " 17 C.F.R. §230.145(a).

Perhaps more troublesome is that the Circuit Court continued to defer to the Commission's proposed interpretation of reclassifications notwithstanding the SEC's admission that it deliberately left the term undefined so as to "maintain regulatory flexibility." SEC *Amicus* Brief at 7. The Commission's acknowledged effort of purposely avoiding a precise definition of a term currently contained in the regulation is prohibited by the APA (*see, e.g., Paralyzed Veterans, supra*), and, therefore, Petitioner respectfully submits, can not possibly serve as the basis for a grant of deference. Indeed, the admitted attempt to maintain regulatory flexibility in an area of the law where it lacks enforcement authority is also plainly improper because it seeks to expand the Commission's jurisdiction beyond the statutory limits placed by Congress. *Accord, Adams Fruit Co. v. Barrett*, 494 U.S. 638, 649-50 (1990)).

D. An Exemption for Essentially All Reclassifications Including Those That Provide the Potential for Speculative Abuse Exceeds the Commission's Statutory Exemptive Authority

The Circuit Court opined that the SEC's determination in Amended 16b-7 to essentially exempt all reclassifications from Section 16(b) liability and its assertion that this blanket exemption should be retroactively read into Rule 16b-7 is a policy judgment concerning the application of Section 16(b) that is entitled to deference under this Court's decision in *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). *See Bruh*, 464 F.3d at 207-08 (App. 9-10). As stated by the Circuit

Court, however, the SEC's power to exempt transactions from Section 16(b) is specifically limited to those transactions that are not "comprehended within the purpose of this subsection." *See Bruh*, 464 F.3d at 207-08 (App. 9-10) (citing 15 U.S.C. §78p(b)).

Chevron clearly states that "[i]f a court, employing traditional tenets of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect." *Chevron*, 467 U.S. at 843 n.9. In the context of Section 16(b), the application of traditional tenets of statutory construction clearly demonstrate Congress' intent and purpose in adopting Section 16(b). That clear intent and purpose are contrary to the exemption adopted in Amended 16b-7 and that intent and purpose should be given effect as a matter of law.

As the Circuit Court, as well as the Commission, note, the introductory sentence of the statute provides that the purpose of Section 16(b) is to prevent "the unfair use of information which may have been obtained by [a] beneficial owner, director, or officer by reason of his relationship to the issuer. . . . " 15 U.S.C. §78p(b). "Prohibiting short-swing trading by insiders with nonpublic information was an important part of Congress' plan in the 1934 Act to 'insure the maintenance of fair and honest markets.'" *Gollust*, 501 U.S. at 121 (citing to 15 U.S.C. §78p(b)). "Congress enacted a 'flat rule [in §16(b)] taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great.'" *Id.* (citing *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418, 422 (1972)). "The statute imposes a form of strict liability on 'beneficial owner[s],' as well as on the issuer's officers and directors, rendering them liable to suits requiring

them to disgorge their profits even if they did not trade on inside information." *Gollust*, 501 U.S. at 122 (citing *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 595 (1972)).

"In a footnote in *Kern County Land Co.* the Supreme Court stated that reclassifications are among those transactions labeled 'unorthodox.'" *Levy*, 314 F.3d at 118 (citing to *Kern County*, 411 U.S. at 593 n.24). Under the *Kern County* analysis, unorthodox transactions are subject to Section 16(b) liability to the extent "the transaction gives rise to the potential for the type of speculative abuse that Congress enacted section 16(b) to prevent." *Id.* (citing to *Kern County*, 411 U.S. at 594). Thus, to the extent a reclassification transaction gives rise to the potential for speculative abuse or unfair use of inside information, the transaction is comprehended within the purpose of the statute and subject to the liability provisions of Section 16(b). As such, pursuant to the explicit terms of Section 16(b), the SEC is without authority to grant a blanket exemption for all such transactions.

Indeed, this Court has consistently ***rejected*** the views of the SEC when it comes to interpreting the proper scope of Section 16(b) liability. *See Gollust*, *supra*;[13] *Reliance Electric*, 404 U.S. at 426-27; *Blau v. Lehman*, 386 U.S. 403, 413 (1962); *accord*, *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 259-60 (1976). The same result should follow here as the SEC in adopting Amended 16b-7

[13] *Gollust* reflects a post-*Chevron* rejection of a proposed SEC rule to govern standing to sue in Section 16(b) actions. *See* A.S. Jacobs, *Section 16 of the Securities Exchange Act*, §3:36 at 3-301 (July 2002) (SEC proposed a Rule 16a-1(h) with a different rule of standing than the one adopted in *Gollust*).

(as well as its proposed interpretation of Rule 16b-7) clearly exceeded the scope of the Commission's delegated authority.

The exemption provided by Amended 16b-7, which essentially provides a blanket exemption for all reclassifications, clearly exempts transactions that permit statutory insiders to unfairly profit from inside information and to engage in the speculative abuse Congress sought to prevent. For example, the transactions at issue in both *Levy* and *Bruh* involved insiders who voluntarily acquired common stock in connection with an issuer's IPO and realized profits as a consequence of short-swing sales shortly thereafter prior to precipitous drops in the market price of the stocks. It should be beyond dispute, considering events of the past decade, that the acquisition of common stock in connection with an IPO presents the potential for the speculative abuse of inside information that Congress sought to prevent. *See generally*, *In re Initial Public Offering Sec. Litig.*, 241 F. Supp. 2d 281 (S.D.N.Y. 2003).

Armed with inside information, insiders are in a position to influence the timing and pricing of an IPO to provide themselves with the opportunity to realize short-swing profits. Moreover, insiders are often in a position to influence corporate events which permit them to effectuate reclassifications timed to unfairly take advantage of inside information. The facts in *Levy* strongly demonstrate this point, as the insider defendants in that case were in control of the issuer's board of directors and thereby effectuated a reclassification prior to the IPO. This transaction clearly gave rise to the potential for speculative abuse as the transaction could have been timed by the insider defendants to take advantage of inside information. *See Levy*,

314 F.3d at 119 (the Third Circuit found that the plaintiff could demonstrate facts showing that the reclassification transaction at issue had the potential for speculative abuse by insiders).

As a consequence of the foregoing, the Third Circuit in *Levy*, following a long line of case law, limited the reclassification exemption to those transactions that do not change an insider's proportionate ownership interest in the issuer and that do not involve a change in the risks and opportunities associated with the insiders' investment in the issuer. *See Levy*, 314 F.3d at 117. These limitations appropriately further "Congress' purpose in enacting section 16(b) by depriving the insiders from obtaining short-swing profits because of their access to inside information not available to the investing public." *Id.* In contrast, the exemption adopted by the SEC in Amended 16b-7 and which the SEC seeks to have read into Rule 16b-7, directly conflicts with Congress' purpose in that it exempts transactions such as those at issue in *Levy* and *Bruh* that permit insiders to unfairly use inside information in order to realize short-swing profits.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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MARC BRUH, Plaintiff-Counter-Defendant-Appellant,-against-BESSEMER VENTURE PARTNERS III L.P., Defendant-Counterclaimant-Appellee, VISTACARE, INC., Defendant.

Docket No. 05-5271-cv

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

464 F.3d 202; 2006 U.S. App. LEXIS 23593; Fed. Sec. L. Rep. (CCH) P93,948

April 7, 2006, Argued
September 13, 2006, Decided

COUNSEL: JEFFREY S. ABRAHAM (Mitchell M.Z. Twersky and Ximena Skovron, on the brief), Abraham Fruchter & Twersky, LLP, New York, NY, for Plaintiff-Counter-Defendant-Appellant.

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JUDGES: Before: McLAUGHLIN, CABRANES, Circuit Judges, and GLEESON, District Judge.[1]

OPINION BY: JOHN GLEESON

OPINION:

JOHN GLEESON, *Judge*:

Marc Bruh, a shareholder in VistaCare, Inc. ("VistaCare"), brought this action against Bessemer Venture Partners III, L.P. ("Bessemer"), pursuant to § 16(b) of the

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[1] The Honorable John Gleeson, United States District Judge for the Eastern District of New York, sitting by designation.

Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), seeking disgorgement of the profit Bessemer made when it sold shares of VistaCare common stock on May 13, 2003. The question presented on appeal is whether a stock reclassification – converting Bessemer's preferred stock into common – that occurred in December 2002 can properly be matched against that sale and thus give rise to liability for short-swing insider trading under § 16(b). The United States District Court for the Southern District of New York (George B. Daniels, *Judge*) granted summary judgment for the defendants, and we affirm, though we arrive at that result by a different route.

BACKGROUND

The relevant facts are not in dispute. In 1995 Bessemer purchased 305,292 shares of Series A-1 preferred stock in Vista Hospice Care, Inc. ("VHS") for $9.90 per share. By a recapitalization in 1998, VHS became a wholly-owned subsidiary of VistaCare, and Bessemer's shares in VHS were converted to Series A-1 preferred shares in VistaCare. Bessemer then, and at all times relevant thereafter, owned more than ten percent of VistaCare's stock and was therefore subject to § 16(b) liability as a statutory insider.[2]

In 1999 the VistaCare shareholders adopted a Third Amended and Restated Certificate of Incorporation, which provided:

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[2] Section 16(b) applies to "[e]very person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered pursuant to section 781 of this title, or who is a director or an officer of the issuer of such security." 15 U.S.C. § 78p(a)(1).

> Upon the closing of a Qualified Initial Public Offering ["IPO"], each outstanding share of Series A-1 Preferred Stock shall automatically be converted into a number of shares of Class A Common Stock equal to (i) the Original Issue Price of the Series A-1 Preferred Stock (as adjusted for any stock splits, stock dividends, recapitalizations and similar events), plus all accrued but unpaid dividends on such shares . . . , divided by (ii) the per share price at which the Common Stock is sold to the public in the . . . [IPO].

Two aspects of this provision are worthy of note. First, the conversion formula ensured that the aggregate value of Bessemer's investment in VistaCare would remain the same through the conversion: the greater the IPO price relative to the value of each of Bessemer's preferred shares, the fewer common shares Bessemer would receive, and vice versa. Second, the conversion was to be automatic. After negotiating the Third Amended Certificate, Bessemer did not retain the option of keeping its preferred shares in the event of a "[q]ualified" IPO, nor did it have the right to convert its preferred shares to common at any earlier time.

On December 17, 2002, VistaCare announced a Qualified IPO [3] and set the price of the offering at $12.00

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[3] Whether an IPO "[q]ualified" was complicated. Specifically, a "Qualified Initial Public Offering" was defined as "a public offering of Common Stock managed by a nationally recognized investment banking firm pursuant to a registration statement filed with the Commission setting forth an anticipated public offering price range, the mid-point of which is equal to or greater than the greater of: (i) $7.50 per share (appropriately adjusted for stock splits, stock dividends, recapitalizations and similar events) or (ii) the lesser of (A) $12.50 per share (appropriately adjusted for stock splits . . . [etc.]) or (B) three

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per share. On December 23, 2002, the deal closed, and Bessemer's preferred stock was converted into 251,865 shares of common stock. Trading opened at $15.90 per share. On May 13, 2003, VistaCare made a secondary offering of stock at $20.00 per share. Although Bessemer had requested that the secondary offering be delayed (perhaps in the hope of avoiding this lawsuit by allowing the six-month time frame in which short-swing trading is prohibited to expire), VistaCare declined, and Bessemer sold anyway. At the net price of $18.95 per share, compared to the $12.00 per share IPO price, Bessemer earned a profit of $1,725,275.25 on the 251,865 shares it acquired by the conversion of its preferred shares.[4] This action followed.

The district court granted summary judgment for Bessemer, concluding that "[t]he 'purchase' in the instant matter occurred at the time Bessemer contracted, . . . in 1995, to acquire [VHS] Preferred Stock." That, the district court held, was "when Bessemer's rights and obligations became fixed and irrevocable." [SA 8.] Bruh appealed, and we invited the Securities and Exchange Commission ("SEC") to participate as *amicus curiae*.

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times the Conversion Price of the Series B Preferred Stock, and which would, based on such mid-point, result in gross proceeds to the Corporation and/or selling stockholders of at least $25,000,000." Thus, the qualifying midpoint price – "equal to or greater than the greater of" those two defined quantities – was merely a floor, below which the conversion provision would not be triggered; contrary to Bruh's suggestion at oral argument, there was no ceiling price, above which an IPO would not qualify.

[4] We note that $6.95, the profit per share, multiplied by 251,865 shares equals $1,750,461.75. The record does not disclose why the profit Bruh seeks to recover is approximately $25,000 less, but neither the difference nor the reason for it has any bearing on this appeal.

DISCUSSION

We review the district court's grant of summary judgment *de novo*, *see Miller v. Wolpoff & Abramson, L.L.P.*, 321 F.3d 292, 300 (2d Cir. 2003), and we may affirm on any basis for which there is sufficient support in the record, including grounds not relied on by the district court, *see Shumway v. United Parcel Service, Inc.*, 118 F.3d 60, 63 (2d Cir. 1997).

Congress enacted § 16(b) "[f]or the purpose of preventing the unfair use of information" by corporate insiders trading securities issued by the company they manage or in which they hold a significant ownership interest. 15 U.S.C. § 78p(b).[5] The mechanism adopted to that end is "a

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[5] Section 16(b) provides:

Profits from purchase and sale of security within six months

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) or a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) involving any such equity security within any period of less than six months, unless such security or security-based swap agreement was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security or security-based swap agreement purchased or of not repurchasing the security or security-based swap agreement sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any

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flat rule taking the profits out of a class of transactions" – so-called "short-swing" transactions involving a stock purchase and sale (or sale and purchase) by an insider within a period of less than six months – "in which the possibility of abuse was believed to be intolerably great," *Kern County Land Co., v. Occidental Petroleum Corp.*, 411 U.S. 582, 592, 93 S. Ct. 1736, 36 L. Ed. 2d 503 (1973) (internal quotation marks omitted). Any profit realized from such a transaction is recoverable by the corporation in a suit against the insider, brought either by the corporation itself or, as in this case, on behalf of the corporation by a shareholder.

Congress further provided, however, that § 16(b) "shall not be construed to cover . . . any transaction or transactions which the [Securities and Exchange] Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection." 15 U.S.C. § 78p(b). One such exemption, Rule 16b-7, 17 C.F.R. § 240.16b-7, is the focus of the dispute between the parties here. And because that rule was amended by the Commission in 2005, after the transactions giving rise to this case took place, *see Ownership Reports and Trading by Officers, Directors and Principal Security Holders,* Exchange Act Release No. 52202, 70 Fed. Reg. 46080 (Aug. 9, 2005) (hereinafter "2005 Release"), the case implicates two versions of the Rule 16b-7 exemption.

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transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security or security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

Bruh contends that under the old Rule 16b-7, as interpreted by the Third Circuit in *Levy v. Sterling Holding Company,* 314 F.3d 106 (3d Cir. 2002), the conversion of Bessemer's preferred stock into common was not exempt. He further contends that to the extent the new Rule 16b-7 would exempt that conversion, it may not be applied retroactively, *see Bowen v. Georgetown Univ. Hosp.,* 488 U.S. 204, 208, 109 S. Ct. 468, 102 L. Ed. 2d 493 (1988). Bessemer, with support from the Commission, argues that the new Rule 16b-7 is merely the old Rule properly understood. The Third Circuit's decision in *Levy,* they contend, was issued only "[i]n the absence of specific SEC guidance" on the question, 314 F.3d at 114, and that guidance having now been supplied, the Commission's reasonable interpretation of its own rule is entitled to deference under *Bowles v. Seminole Rock & Sand Company,* 325 U.S. 410, 413-14, 65 S. Ct. 1215, 89 L. Ed. 1700 (1945); *see also Auer v. Robbins,* 519 U.S. 452, 461-62, 117 S. Ct. 905, 137 L. Ed. 2d 79 (1997).

We hold that the Commission's construction of the old Rule 16b-7 is not plainly erroneous, and it is therefore controlling.[6] So construed, the rule relieves Bessemer of liability here.

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[6] The district court approached the case from the opposite direction, asking first whether the conversion of Bessemer's preferred stock into common constituted a "purchase" under § 16(b). It cited our advice in *Blau v. Lamb,* 363 F.2d 507, 518 (2d Cir. 1966) that "in deciding whether a certain transaction is a Section 16(b) 'purchase' or 'sale' it is relevant to first consider whether the transaction in any way makes possible the unfair insider trading that Section 16(b) was designed to prevent." *See also Reliance Elec. Co. v. Emerson Elec. Co.,* 404 U.S. 418, 424 n.4, 92 S. Ct. 596, 30 L. Ed. 2d 575 (1972) ("In interpreting the terms 'purchase' and 'sale,' courts have properly asked whether the particular type of transaction involved is one that gives rise to speculative abuse.").

(Continued on following page)

A. *Seminole Rock* Deference

We do not examine the Commission's exemptive rules with fresh eyes. Rather, in the "interpretation of an administrative regulation a court must necessarily look to the administrative construction of the regulation if the meaning of the words used is in doubt . . . [T]he administrative interpretation . . . becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation." *Seminole Rock,* 325 U.S. at 413-14; *see also Press v. Quick & Reilly, Inc.,* 218 F.3d 121, 128 (2d Cir. 2000) ("We are bound by the SEC's interpretations of its regulations in its *amicus* brief, unless they are plainly erroneous or inconsistent with the regulations.") (internal quotation marks omitted); *Levy v. Southbrook Int'l Investments, Ltd.,* 263 F.3d 10, 16 (2d Cir. 2001) (deference owed to SEC's interpretation of rules implementing § 16(b) when "neither plainly erroneous nor inconsistent with the regulations"). It is "axiomatic that the [agency's] interpretation need not be the best or most natural one by grammatical or other standards . . . Rather, the [agency's] view need be only reasonable to warrant deference." *Pauley v.*

Concluding that Bessemer's operative "purchase" occurred in 1995 – a determination as to which we express no opinion – the district court had no need to consider Bessemer's argument that Rule 16b-7 exempted this transaction.

Although consideration – as a threshold matter – of whether a transaction constitutes a "purchase" may be necessary when it is clear that no exemption applies, *see At Home Corp. v. Cox Communs., Inc.,* 446 F.3d 403, 408-10 (2d Cir. 2006), such threshold consideration is not necessary where, as here, the transaction arguably falls under one of the enumerated exemptions. In such a case, it may be possible to resolve the parties' claims solely on the ground that the Commission has exercised its delegated authority to exempt the transaction in question. Accordingly, we examine that possibility before proceeding, if necessary, to analyze the statutory language.

Beth Energy Mines, Inc., 501 U.S. 680, 702, 111 S. Ct. 2524, 115 L. Ed. 2d 604 (1991). We are thus obligated to accept the Commission's interpretation of Rule 16b-7 – here expressed both by the Commission's *amicus* brief and by the 2005 amendments to the rule itself – so long as it represents "a plausible construction of the language of the actual regulation," *Ehlert v. United States*, 402 U.S. 99, 105, 91 S. Ct. 1319, 28 L. Ed. 2d 625 (1971); *see also Northern Indiana Pub. Serv. Co. v. Porter*, 423 U.S. 12, 15, 96 S. Ct. 172, 46 L. Ed. 2d 156 (1975) (agency interpretation must "sensibly conform[] to the purpose and wording of the regulations").[7]

We pause briefly to explain the grounds for such deference, which greatly inform our decision here. Like the deference owed under *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984), to an agency's reasonable construction of a statute it administers, *Seminole Rock* deference is justified both by the agency's special expertise in the subject matter – and we have recently acknowledged that the SEC is "an agency uniquely experienced in confronting short-swing profiteering," *At Home*, 446 F.3d at 409 – and by its relative political accountability. As the Court explained in *Chevron*, the resolution of ambiguities in legal texts will more often turn on policy preferences than parsing:

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[7] The views expressed in the Commission's *amicus* brief are the views of the Commission itself and not merely of the staff. *See* Brief of the Securities and Exchange Commission as *Amicus Curiae*, *At Home Corp. v. Cox Commc'ns, Inc.*, No. 05-115-CV, at 25-26 (2d Cir., Feb., 2006).

> Judges are not experts in the field, and are not part of either political branch of the Government. Courts must, in some cases, reconcile competing political interests, but not on the basis of the judges' personal policy preferences. In contrast, an agency to which Congress has delegated policy-making responsibilities may, within the limits of that delegation, properly rely upon the incumbent administration's views of wise policy to inform its judgments. While agencies are not directly accountable to the people, the Chief Executive is, and it is entirely appropriate for this political branch of the Government to make such policy choices – resolving the competing interests which Congress itself either inadvertently did not resolve, or intentionally left to be resolved by the agency charged with the administration of the statute in light of everyday realities.

Chevron, 467 U.S. at 865-66. Accordingly, the Court concluded, when Congress delegates policymaking authority to an agency for the purpose of administering a statute, such authority is presumed to include the interpretive discretion to resolve ambiguities in the statutory scheme. Following *Chevron,* the Court has supported *Seminole Rock* deference by a similar presumption: "Because applying an agency's regulation to complex or changing circumstances calls upon the agency's unique expertise and policymaking prerogatives, we presume that the power authoritatively to interpret its own regulations is a component of the agency's delegated lawmaking powers." *Martin v. OSHRC,* 499 U.S. 144, 151, 111 S. Ct. 1171, 113 L. Ed. 2d 117 (1991). Agencies have an additional advantage in interpreting their own regulations, namely, that because the agency promulgates the regulations, it is in a superior position "to reconstruct the purpose of the regulations in

question." *Id.* at 153. Here, Congress explicitly delegated to the Commission the policymaking authority to exempt certain transactions "as not comprehended within the purpose of this subsection," and took the further step of admonishing the courts that the statute "shall not be construed" otherwise. 15 U.S.C. § 78p(b).[8]

With these principles in mind, we turn to Rule 16b-7.

B. Rule 16b-7

We first note that under either version of Rule 16b-7, old or new, the conversion of Bessemer's preferred stock into common is exempt only if it can properly be called a "reclassification." Although the term "reclassification" has never been defined in the text of the rule, the release notes accompanying the 2005 amendments provide this explanation:

> [T]ransactions that are exempt as reclassifications generally include transactions in which the terms of the entire class or series are changed, or securities of the entire class or series are replaced with securities of a different class or series of securities of the company, and all holders of the reclassified class or series are entitled to

[8] Bruh argues that because the Commission lacks the authority to bring its own enforcement actions pursuant to § 16(b), the usual rule of deference under *Seminole Rock* should not apply to the Commission's rules exempting transactions from § 16(b) liability. We held otherwise in *Levy v. Southbrook Int'l Investments, Ltd.*, 263 F.3d at 16, and for the reasons just explained – Congress explicitly delegated policymaking authority to the Commission, which is "uniquely experienced in confronting short-swing profiteering," *At Home*, 446 F.3d at 409 – we see no reason to retreat from that position.

> receive the same form and amount of consideration per share . . . These transactions . . . do not involve a substantial change in the business owned, do not involve the holders' payment of consideration in addition to the reclassified class or series of securities, and have the same effect on all holders of the reclassified class or series . . .

2005 Release, 70 Fed. Reg. at 46085.

We agree with the Commission that the automatic conversion of Bessemer's preferred stock into common was "a classic reclassification . . . . encompass[ing] the simple exchange of one entire series of stock, VistaCare preferred stock, for another series of stock, VistaCare common stock, under circumstances where the holders of the preferred stock received the same form and amount of consideration per share." Bruh's only argument to the contrary is entirely unpersuasive.[9] He contends that Bessemer did not

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[9] In his supplemental brief responding to the Commission's *amicus* filing, Bruh asserts two new arguments in this regard. These arguments, which are not based on any point raised by the Commission that Bessemer had not already advanced, come too late for our consideration. *See United States v. Yousef*, 327 F.3d 56, 115 (2d Cir. 2003) (argument forfeited because not raised in initial appellate brief). In any event, we do not find them compelling. The first – that the Commission is required to borrow from state law in defining the term "reclassification," rather than adopting its own definition as it did in the 2005 Release, 70 Fed. Reg. at 46085 – means nothing to this case unless Bruh is also correct in suggesting that the conversion at issue here failed to satisfy the requirements of shareholder assent under Delaware law. That suggestion is rejected, as we explain in the text: the Third Amended Certificate was itself adopted in accordance with Delaware law, and the automatic conversion at issue here required no further approval. Bruh's second forfeited argument is based on his theory that the fixing of the IPO price, and thus the conversion ratio, constituted a "purchase" within the meaning of Rule 16b-6(a) by establishing a call

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regard the conversion at issue as a reclassification because the Third Amended and Restated Certificate requires that reclassifications be approved by "the affirmative vote or written consent of . . . two-thirds or more of the then outstanding shares of" preferred stock, and there is no evidence that such a vote ever took place after the requirement came into effect. But the very same Third Amended and Restated Certificate, which was itself "duly adopted by both the Board of Directors and the stockholders of the Corporation in accordance with the . . . General Corporation Law of the State of Delaware," required, upon a Qualified IPO, that all Series A-1 preferred stock be *automatically* converted into common stock. Because the Third Amended Certificate thus required no further approval for this transaction, the fact that no further approval was sought does not tend to show that Bessemer regarded the conversion as something other than a reclassification.

Our primary task, therefore, is to determine the extent to which the pre-2005 Rule 16b-7 exempted reclassifications. The rule then provided, in relevant part:

> Mergers, reclassifications, and consolidations.
>
> (a) The following transactions shall be exempt from the provisions of section 16(b) of the Act:

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equivalent position. The fixing of the purchase price, Bruh contends, should be considered separately from the conversion and can be matched independently against the May 2003 sale. The Commission disagrees, stating: "Both the December 17 fixing of the conversion price and the December 23 conversion of preferred into common are eligible for the Rule 16b-7 exemption, since they were both steps in the reclassification." We agree with the Commission. Indeed, it would make little sense to exempt the reclassification as a whole but impose separate liability for the component steps in that process.

> (1) The acquisition of a security of a company, pursuant to a merger or consolidation, in exchange for a security of a company that before the merger or consolidation, owned 85 percent or more of either:
>
> (i) The equity securities of all other companies involved in the merger or consolidation, or in the case of a consolidation, the resulting company; or
>
> (ii) The combined assets of all the companies involved in the merger or consolidation, computed according to their book values before the merger or consolidation as determined by reference to their most recent available financial statements for a 12 month period before the merger or consolidation, or such shorter time as the company has been in existence.

The Commission had amended Rule 16b-7 in 1991 to add the word "reclassifications" to the title, but not to the text, *see Ownership Reports and Trading By Officers, Directors and Principal Security Holders,* Exchange Act Release 28869, 56 Fed. Reg. 7242, 7273 (Feb. 21, 1991) ("1991 Release"), thus creating a glaring ambiguity: just how did the Commission mean for the rule to apply to reclassifications? The Commission amended Rule 16b-7 again in 2005, this time inserting "reclassification" throughout: each instance of "merger or consolidation" became "merger, reclassification or consolidation." The Commission contends that the 2005 amendments merely clarified its prior understanding of the rule, namely "that reclassifications are exempt under the same standards as mergers and consolidations." In other words, the Commission's answer is that the 1991 change in the title was meant to apply throughout the rule. That interpretation, argues the

Commission, which is evidenced by both the 2005 amendments and its *amicus* brief in this case, is entitled to deference.

In assessing that argument, it is helpful to consider whether the Commission's current interpretation is consistent with how it has treated reclassifications under Rule 16b-7 in the past. *See Gardebring v. Jenkins,* 485 U.S. 415, 430, 108 S. Ct. 1306, 99 L. Ed. 2d 515 (1988) (noting the relevance of "indications of the Secretary's intent at the time of the regulation's promulgation" in determining whether deference to administrative construction of regulation is appropriate). Rule 16b-7 was originally promulgated in 1952, and it mentioned only "mergers and consolidations." *See Exemption of Certain Transaction from Section 16(b),* Exchange Act Release No. 4717, 17 Fed. Reg. 5501 (June 19, 1952, and corrected July 18, 1952 at 17 Fed. Reg. 6579). The courts were left to deal with reclassifications case-by-case, and no black-letter rule emerged; in determining whether a certain transaction could possibly give rise to the speculative abuse § 16(b) was aimed at preventing, courts weighed such factors as whether the defendant's proportionate interest in the issuer remained the same through the transaction, whether the transaction was disclosed to and approved by the shareholders, and whether all shareholders in the class were treated alike. *See Roberts v. Eaton,* 212 F.2d 82, 85 (2d Cir. 1954) (collecting early cases).

In 1981, the Commission published a statement "setting forth the views of its Division of Corporation Finance on various interpretive questions regarding the rules promulgated under Sections 16(a) and 16(b)," *Interpretive Release on Rules Applicable to Insider Reporting and Trading,* Exchange Act Release No. 34-18114, 46 Fed.

Reg. 48147 (Sept. 24, 1981) ("Interpretive Release"), in which it undertook to answer the following question: "Although not specifically mentioned, does Rule 16b-7 apply to transactions structured as (1) statutory exchanges; (2) liquidations; or (3) reclassifications?" *Id.* at 48176-77. With respect to reclassifications, the Commission staff sparsely responded that "Rule 16b-7 does not require that the security received in exchange be similar to that surrendered, and the rule can apply to transactions involving reclassifications." *Id.* at 48177. As Bruh points out, that response standing alone does not clear up the issue: Does "can apply" mean "applies," or instead that the rule applies merely to some but not all reclassifications? Does "transactions involving reclassifications" mean simply "reclassifications," or does it import that a reclassification alone is somehow insufficient without a complementing step?

Taken in context, however, the reasoning the Commission advances here – that reclassifications are exempt where they are the substantive equivalent of a merger that would be exempt under the rule – comes into focus through the explanation it gave concerning transactions structured as a "statutory exchange," which immediately preceded the response concerning reclassifications in the Interpretive Release:

> The staff is of the view that, for purpose[s] of Rule 16b-7, a statutory exchange may be the substantive equivalent of a merger, consolidation or sale of assets. Therefore, the acquisition and disposition of stock in a statutory exchange would be exempt under Rule 16b-7, assuming all of the conditions of the rule are satisfied . . .

> [For example, suppose] Company B is a savings and loan association organized in the State of Virginia. Company A, a wholly-owned subsidiary of Company B, was incorporated under the laws of Virginia for the sole purpose of acquiring all the outstanding shares of capital stock of Company B. The purpose was to create a holding company which would be able to acquire other savings and loan institutions in Virginia. Under Virginia law, Company B is not permitted to acquire stock of other savings and loan associations. As a result of the exchange, Company B became a wholly-owned subsidiary of Company A, and the former Company B shareholders became the owners of all the outstanding shares of Company A. This transaction was implemented pursuant to statutory 23 procedures under Virginia law . . . The acquisition by Company B stockholders of common stock of Company A and the corresponding disposition of the Company B stock in exchange fall within the terms of Rule 16b-7.

Id. at 48177. The Commission uses that same logic in its *amicus* brief in this case:

> In relevant respects a reclassification is little different from a merger exempted by Rule 16b-7. In both cases, all stock in a class is exchanged on terms that have been approved by the board and/or shareholders. The exchange occurs on a class-wide basis . . . Indeed, the similarities between the two can be readily seen by the fact that a reclassification could also be effected by the issuer creating a new shell company, capitalizing it, merging the old company into the new,

> and then exchanging stock in the old company for stock in the new.[10]

Thus, according to the Commission, the greater exemption for short-form mergers implicitly includes the lesser exemption for a reclassification that is a functional equivalent.

The Commission next addressed the issue in 1991, as we explained above, when it amended the title (and only the title) of Rule 16b-7 to include "reclassifications." 1991 Release, 56 Fed. Reg. at 7242, 7273. The Commission provided no explanation for the amendment except to note

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[10] Bruh argues, without any elaboration, that the Commission is wrong on this point because the "shell company" merger described would actually be a non-exempt liquidation, which the Commission explained in a second illustration following the Virginia example quote above:

> Illustration (2): Company X is a holding company whose principal asset is 100,000 shares of Company Y common stock, roughly 6 percent of the total number of shares of such stock issued and outstanding. Company X proposes to liquidate so that its shareholders will hold the stock of Company Y directly. Pursuant to the liquidation plan, shareholders of Company X will exchange their shares of Company X for those of Company Y on a pro rata basis.
>
> Interpretation: The acquisition and disposition of such shares is not exempt under Rule 16b-7. This transaction is not substantially similar to a merger or consolidation, nor does it meet the standards of paragraph (a) of the rule which provides that the acquisition and disposition of securities in connection with a merger or consolidation is exempt from Section 16(b) where 85 percent or more of the assets or securities of all other companies involved in the transaction is owned by another party to the transaction.

1981 Release, 46 Fed. Reg. at 48177. It seems to us that the "shell company" merger the Commission suggests is nearly identical to the Virginia example and to be distinguished, for the reasons the Commission gave, from the second example involving a liquidation.

that it intended no "substantive" change to the rule. *Id* at 7261-62. It did include a chart updating the 1981 Interpretive Release where necessary to account for the 1991 amendments, but there was no change to the interpretation quoted above concerning reclassifications. *Id.*

In April 2002, a few months before the VistaCare IPO, the Commission issued a proposed rule amending Form 8-K, which sets forth reporting requirements similar to those under Section 16(a), 15 U.S.C. § 78p(a), for transactions involving officers and directors. The Commission proposed that "[a]cquisitions or dispositions pursuant to holding company formations and similar corporate reclassifications and consolidations" be exempt from reporting on the ground that "[t]hese are the transactions exempted from Section 16(b) short-swing profit recovery by Exchange Act Rule 16b-7." *Form 8-K Disclosure of Certain Management Transactions,* 67 Fed. Reg. 19914, 19919 & n.56 (Apr. 23, 2002). That statement also lacks perfect clarity, but it is certainly consistent with the position the Commission maintains here, namely, that Rule 16b-7 exempts reclassifications "under the same standards as mergers and consolidations."

Shortly thereafter – in fact, during the week between the fixing of VistaCare's IPO price and the closing – the Third Circuit decided *Levy v. Sterling Holding Company,* 314 F.3d 106 (3d Cir. 2002). In that case, the plaintiff alleged that an automatic conversion of previously non-convertible preferred stock into common stock in preparation for an IPO constituted a non-exempt "purchase" under § 16(b). The district court dismissed the complaint on the ground that Rule 16b-7 provided an exemption, but the Third Circuit reversed. Proceeding "[i]n the absence of specific SEC guidance about which reclassifications are

exempt from section 16(b) under Rule 16b-7," *id.* at 114, the court concluded that the transaction was not exempt, in part on the ground that "the risks and opportunities of shareholders of nonconvertible preferred stock . . . are very different than the risks and opportunities of shareholders holding common stock," *id.* at 117.

Bruh urges us to adopt the Third Circuit's approach in *Levy* as the correct view of Rule 16b-7 prior to the 2005 amendments, and, given the factual similarity between the two cases, to decide this case in his favor. But even if we found *Levy* persuasive[11] and not distinguishable,[12] we now have precisely what the Third Circuit lacked when conducting its inquiry in that case: the answer to whether "the conversion of the preferred stock . . . [w]as the type of reclassification that the SEC would . . . have intended to exempt by Rule 16b-7" *Levy,* 314 F.3d at 117. The Commission has stated, through both its *amicus* brief in this case and the 2005 amendments to Rule 16b-7, its view that a reclassification is exempt where it is the "substantive equivalent" of a merger that would be exempt. That view,

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[11] The Commission argues convincingly that *Levy's* reliance on the different risks and opportunities associated with preferred and common shares is contrary to the SEC's 1981 interpretation that "Rule 16b-7 does not require that the security received in exchange be similar to that surrendered." Interpretive Release, 46 Fed. Reg. at 48177. Indeed, as the Commission points out, "if the original security and the security for which it is being exchanged were precisely the same, there typically would be little need for a reclassification at all."

[12] The Third Circuit was careful to point out that in *Levy,* "both the amendment of Fairchild's certificate of incorporation, which made the conversion possible, and the actual conversion took place with the six-month period prior to the January 19, 2000 sales date," 314 F.3d. at 117, whereas in this case, the Third Amended Certificate requiring the automatic reclassification was adopted nearly three years before the reclassification.

we think, is plausible in light of the 1991 addition of "reclassifications" to the title of the rule and can reasonably be reconciled with the regulatory history of the Commission's treatment of reclassifications. As the Supreme Court has explained, "[w]here . . . a court is addressing transactions that occurred at a time when there was no clear agency guidance, it would be absurd to ignore the agency's current authoritative pronouncement of what the statute means." *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 744 n.3, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996). We similarly conclude it is proper here to credit the Commission's current authoritative construction of its own regulation.

In so holding, we acknowledge that we could have proceeded differently in analyzing this case. A reasonable alternative approach would have been to ask first whether Rule 16b-7, as amended in 2005, exempts the conversion at issue (a question we would answer in the affirmative), and then proceed to determine whether the new rule has impermissible "retroactive effect" within the meaning of *Bowen v. Georgetown University Hospital,* 488 U.S. 204, 208, 109 S. Ct. 468, 102 L. Ed. 2d 493 (1988) ("[A] statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms."), and the cases following it explaining retroactivity doctrine. *See Landgraf v. USI Film Prod.,* 511 U.S. 244, 280, 114 S. Ct. 1483, 128 L. Ed. 2d 229 (1994) ("[T]he court must determine whether the new statute would have retroactive effect, *i.e.,* whether it would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed.");

I.N.S. v. St. Cyr., 533 U.S. 289, 321, 121 S. Ct. 2271, 150 L. Ed. 2d 347 (2001); *Arenas-Yepes v. Gonzales*, 421 F.3d 111, 117 (2d Cir. 2005). We think the question of whether the current Rule 16b-7 would have retroactive effect if applied to the transaction at issue here turns primarily upon the answer we have given above, namely, that even applying the prior Rule 16b-7, according to the Commission's reasonable interpretation, the transaction is exempt. Needless to say, where applying the old rule produces the same result as would the new rule, there is no impermissible retroactive effect.

Finally, we disagree with Bruh's contention that this transaction did indeed present the danger of unfair use of insider information, and therefore the Commission was without authority to exempt it. On that score, Bruh again faces an uphill battle, for as we have explained above, the Commission's interpretation of § 16(b), embodied in the amended Rule 16b-7, is entitled to *Chevron* deference so long as it represents a permissible understanding of Congress's intent.[13] Indeed, the implementation of Congress's objectives – and thus the decision as to whether certain transactions are exempt – falls primarily to the Commission, and not to the courts. The statute's prohibitions explicitly do not "cover any transactions *which the*

[13] In *At Home*, we reserved the question of whether *Chevron* deference was due an interpretation of § 16(b) adopted by the Commission for the first time in an *amicus* brief, that is, on an issue as to which the Commission had never exercised its rulemaking authority. 446 F.3d at 409 & n.5. We need not decide that question today because the Commission's position in this case was adopted not only in an *amicus* brief, but also "by rules and regulations," 15 U.S.C. § 78p(b), the very procedure Congress prescribed in delegating exemptive authority to the Commission.

Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection." 15 U.S.C. § 78p(b) (emphasis added).

The purpose of § 16(b) was clearly articulated by Congress and fully supports the Commission's interpretation. Section 16(b) was enacted "[f]or the purpose of preventing the unfair use of information which may have been obtained by" insiders. *Id.* Bruh's theory of potential harm in this case is that Bessemer could have used its insider position to push the price of the IPO artificially downward. Whatever advantage Bessemer may have thus gained, however, it was not an *informational* advantage, which, as the statutory text makes clear, was the only type of insider advantage Congress intended § 16(b) to strip away. There is no allegation that any of the information in the various registration statements filed in connection with the VistaCare IPO was false, misleading, or incomplete in any way. And even if Bessemer did have access to information that the IPO would be priced below an honest assessment of the company's value, Bessemer would not have been in a position to act on it in any way with respect to its preferred shares, since Bessemer had agreed in 1999 that those shares would be automatically converted to common stock no matter how high the IPO price was. Moreover, Bessemer's shares were converted along with the entire class of stock, and, as Judge Clark observed more than fifty years ago, it cannot "be gainsaid that like treatment of all stockholders will in most cases remove the possibility of abuse." *Roberts v. Eaton,* 212 F.2d 82, 84 (2d Cir. 1954).

In sum, Bruh has not advanced any convincing theory of how the reclassification at issue gave Bessemer an opportunity to exploit insider information to speculative

advantage sufficient to overcome the strong presumption of validity the Commission's exemptive rules enjoy.

CONCLUSION

For the reasons set forth above, we conclude the reclassification of Bessemer's preferred stock into common stock in preparation for the VistaCare IPO was exempt from § 16(b) liability under Rule 16b-7, and that such an exemption falls safely within the Commission's delegated authority. The judgment of the district court is accordingly AFFIRMED.

2005 WL 2087803

MARC BRUH, Plaintiff, -against- BESSEMER VENTURE PARTNERS III L.P., and VISTACARE, INC., Defendants.

03 Civ. 7340 (GBD)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

2005 U.S. Dist. LEXIS 18543

August 26, 2005, Decided
August 29, 2005, Filed

COUNSEL: For Marc Bruh, Plaintiff: Jack G. Fruchter, Abraham, Fruchter & Twersky, L.L.P., New York, NY.

For Bessemer Venture Partners III L.P., Defendant: Frederick R. Kessler, Wollmuth, Maher & Deutsch, L.L.P., New York, NY.

For Bessemer Venture Partners III L.P., Counter Claimant: Frederick R. Kessler, Wollmuth, Maher & Deutsch, L.L.P., New York, NY.

For Marc Bruh, Counter Defendant: Jack G. Fruchter, Fruchter & Twersky, New York, NY.

JUDGES: GEORGE B. DANIELS, United States District Judge.

OPINION BY: GEORGE B. DANIELS

OPINION:

MEMORANDUM DECISION AND ORDER

GEORGE B. DANIELS, DISTRICT JUDGE:

This action arises out of the automatic conversion of Preferred Stock to Common Stock at the closing of

VistaCare, Inc.'s ("VistaCare") initial public offering and the subsequent sale of such stock within six months by Defendant, Bessemer Venture Partners III L.P. ("Bessemer"). Plaintiff, a VistaCare shareholder, sued VistaCare and Bessemer, seeking disgorgement of short-swing profits pursuant to Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) ("Exchange Act"). Defendants counterclaimed, seeking declaratory judgment that the transactions were not subject to Section 16(b) liability, or alternatively, that their transactions were subject to two exceptions that waived liability under Section 16(b). Both Plaintiff and Defendants move for summary judgment pursuant to Federal Rule of Civil Procedure 56. Plaintiff's motion for summary judgment is DENIED. Defendants' motion for summary judgment is GRANTED.

INTRODUCTION

VistaCare is a publicly traded company whose common stock is registered with the Securities and Exchange Commission ("SEC"). Plaintiff is a shareholder of VistaCare. Bessemer, a long-term investor in VistaCare, entered into a Stock Purchase Agreement with Vista Hospice Care, Inc. ("VHS"), pursuant to which Bessemer purchased and acquired 305,292 shares of VHS Series A-1 Preferred Stock in 1995.[1] At the time of this purchase, the Preferred

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[1] Under section titled "Purchase of Shares", the Stock Purchase Agreement states in relevant part:

> 1.1. Number of Shares. On the Closing Date (as specified in Section 5), subject to the terms and conditions hereof and in reliance upon the representations, warranties and agreements contained herein, the Company agrees to sell each Purchaser, and each Purchaser agrees to purchase from the Company, the number of shares of the Company's Series A

(Continued on following page)

Stock was not convertible to common stock. In 1998, as part of a recapitalization, VHS became a wholly owned subsidiary of VistaCare, Inc., and VHS Series A-1 Preferred Stock became VistaCare, Inc. A-1 Preferred Stock.

On December 23, 1999, VistaCare filed a Third Amended and Restated Certificate of Incorporation ("Restated Certificate"). Under the terms of the Restated Certificate, upon closing of an initial public offering of VistaCare Common Stock (the "IPO"), VistaCare Series A-1 Preferred Stock would automatically convert to shares of VistaCare Common Stock. The Restated Certificate set forth a specific ratio under which the preferred stock would be converted to common stock:[2]

> Upon the closing of a Qualified Initial Public Offering, each outstanding share of Series A-1 Preferred Stock shall automatically be converted into a number of shares of Class A Common Stock equal to (i) the Original Issue Price of the Series A-1 Preferred Stock (as adjusted for any stock splits, stock dividends, recapitalizations

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Preferred Stock, $ .01 par value ("Series A Preferred Stock") and the number of shares of the Company's Common Stock, $.01 par value ("Common Stock") set forth opposite the name of such Purchaser on Exhibit A hereto.

(June 4, 2004, Twersky Decl., Ex. 1) (emphasis in original).

[2] This conversion ratio was determined through arms-length negotiation between VHS and Bessemer. (Countercl. at P15). According to Bessemer, the security that was negotiated in 1995 "provided for cash to be paid to redeem the Series A-1 preferred [stock] on an IPO, and [the majority shareholder] objected to that provision because they thought that . . . it was a risk that the company might not have the cash at the time of the IPO." (Kessler Decl. Ex. 7 at 92-93). Bessemer avers that the terms of the conversion were the result of pressure to accommodate VistaCare's majority stockholder. (*Id.* at 93-96).

> and similar events), plus all accrued but unpaid dividends on such shares of Series A-1 Preferred Stock, divided by (ii) the per share price at which the Common Stock is sold to the public in the Qualified Initial Public Offering (the "IPO Price").

(June 4, 2004, Twersky Decl., Ex. 2).

Bessemer argues that because the ratio was fixed and set at the time of the Restated Certificate, even if it were privy to insider information, it would be unable to alter the ratio to take advantage of the information. It is further undisputed that the value of Bessemer's holding was the same after the conversion because under the formula set forth, an increase in the IPO price per share would lead to an offsetting decrease in the number of common shares Bessemer would received in the conversion. Bessemer argues, therefore, that the conversion was not a new investment by Bessemer in VistaCare. The conversion's sole effect on Bessemer's holdings was to change its preferred stock into an equivalent value of common stock.

On December 23, 2002, VistaCare completed the IPO of its common stock at a price of $12.00 per share. Pursuant to the terms of the 1999 Restated Certificate, Bessemer's Preferred Stock was converted to 251,865 shares of Common Stock. On May 13, 2003, VistaCare conducted a secondary offering in which certain selling shareholders, including Bessemer, sold additional shares of VistaCare Common Stock to the public at $20.00 per share (the "Secondary Offering"). At all relevant times, Bessemer held ten percent or more of the stock of VHS or VistaCare. Bessemer did not have a position on VistaCare's Board of Directors. Bessemer had no control over the board or management of VistaCare concerning the timing, form, or

occurrence of the IPO, or the per-share price to the public of VistaCare common stock.[3]

On June 24, 2003, counsel for Plaintiff demanded VistaCare bring suit against Bessemer seeking disgorgement of the profits Bessemer made from their sale in the Secondary Offering. Plaintiff's counsel asserted that Bessemer's acquisition of Common Stock by conversion of its Preferred Stock at the closing of the IPO constituted a "purchase" for purposes of Section 16(b) liability. By letter dated July 2, 2003, VistaCare asked Bessemer to advise why VistaCare should not be entitled to disgorgement of profits.

On July 31, 2003, Bessemer filed a complaint in the United States District Court for the Southern District of New York seeking a declaratory judgment that Bessemer has no Section 16(b) liability because, among other things, the conversion of VistaCare Common Stock pursuant to the closing of the IPO, should not be considered a "purchase" under the SEC's rules. On September 18, 2003, Plaintiff filed the instant Complaint, seeking "disgorgement of short-swing insider trading profits" allegedly realized by Bessemer. Plaintiff seeks disgorgement of short-swing profits in the amount of $1,725,275.25. On October 9, 2003, Bessemer dismissed its separate declaratory judgment action. Bessemer filed an Answer and Counterclaim in Plaintiff's action on October 17, 2003.

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[3] Bessemer offers proof that it urged VistaCare to conduct the Secondary Offering on a later date. This request was rebuffed by VistaCare who went forward with the Secondary Offering in May 2003.

STANDARD OF REVIEW

Summary judgment is proper "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c); *Nebraska v. Wyoming*, 507 U.S. 584, 590, 113 S. Ct. 1689, 1694, 123 L. Ed. 2d 317 (1993). The burden of demonstrating that no factual dispute exists is on the moving party. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986). Once the moving party has met this burden, the nonmoving party "must set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e). In deciding a motion for summary judgment, a court must resolve all ambiguities and draw all reasonable inferences in favor of the party opposing the motion. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986). Summary judgment should be granted only when no reasonable trier of fact could find in favor of the nonmoving party. *Gallo v. Prudential Residential Services, Ltd.*, 22 F.3d 1219, 1224 (2d. Cir.1994).

SECTION 16(b) LIABILITY

Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), which imposes liability for "short-swing" profits, forbids an insider's speculative short-term trading based upon insider information. Its purpose is to prevent corporate insiders from exploiting material information about the issuer to have an advantage over others with whom they trade. *Gwozdsinsky ex rel. Revco D.S., Inc. v. Zell/Chilmark Fund, L.P.*, 156 F.3d 305, 308 (2d Cir. 1998). Section 16(b) provides, in pertinent part:

> For the purposes of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . involving any such equity security within any period of less than six months, . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer. . . .

15 U.S.C. § 78p(b).

Thus, a claim for disgorgement of profits under Section 16(b) requires that Plaintiff prove that there was (1) a purchase (2) and a sale of securities (3) by a statutory insider[4] (4) within a six-month period.[5] *See Feder v. Frost*, 220 F.3d 29, 32 (2d Cir. 2000) (quoting *Gwozdsinsky v. Zell/Chilmark Fund, L.P.*, 156 F.3d 305, 308 (2d Cir. 1998)). Section 16(b) is a strict liability statute which applies "irrespective of any intention on the part of such beneficial owner. . . . " 15 U.S.C. § 78p(b); *see also Magna Power Co. v. Dow Chem. Co.*, 136 F.3d 316, 320-21 (2d Cir. 1998) ("Section 16(b) operates mechanically, and makes no moral distinctions, penalizing technical violators of pure heart, and bypassing corrupt insiders who skirt the letter of the prohibition."); *Schaffer v. CC Invs, et al.*, 280 F. Supp. 2d

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[4] Statutory insiders are the "issuer's directors and officers and any persons who own more than ten percent of any class of the issuer's non-exempt, registered equity securities." *See Gwozdsinsky*, 156 F.3d at 308 n.3 (citing 15 U.S.C. § 78p).

[5] It is undisputed that Bessemer is a statutory insider because it owned more than ten percent of VistaCare, and that Bessemer sold shares of Common Stock at $20.00 per share on May 13, 2003.

128, 133 (S.D.N.Y. 2003) (stating that Section 16(b) "not only prohibited all short-swing trading by an insider within a period of less than six months but did so regardless of whether the insider actually used or even knew of inside information when engaging in the transaction."). Plaintiff argues that Bessemer "purchased" the Common Stock on December 23, 2002, the date of the initial public offering, when Bessemer's Preferred Stock was converted to Common Stock.

Under the Securities Act, the term "'purchase' include[s] any contract to buy, purchase, or otherwise acquire." 15 U.S.C. § 78c(a)(13). The Supreme Court has recognized that the definition of "purchase" applicable to Section 16(b)

> [is] broad, and, at least arguably, reach[es] many transactions not ordinarily deemed a . . . purchase. In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent-the realization of short-swing profits based upon access to inside information-thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits. . . . Thus, "in interpreting the term[] 'purchase' . . . , courts have properly asked whether the particular type of transaction involved is one that gives rise to speculative abuse."

Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582, 593-95, 93 S. Ct. 1736, 36 L. Ed. 2d 503 (1973) (quoting *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 424 n.4, 92 S. Ct. 596, 30 L. Ed. 2d 575 (1972)). The "indices" of speculative abuse require a determination of

whether there was access to inside information (distinguishable from the possession of it) and whether the defendant could influence the timing and circumstances of the transactions at issue. *See Donoghue v. Casual Male Retail Group, Inc.*, 375 F. Supp. 2d 226, 231-32 (S.D.N.Y. 2005); *Makofsky v. Ultra Dynamics Corp.*, 383 F.Supp. 631, 638 (S.D.N.Y. 1974) (citing *Kern*, 411 U.S. at 597-600).

In 1991, the SEC adopted amended rules which considered a "derivative security" as a Section 16(b) purchase. A derivative security is "any option, warrant, convertible security, stock appreciation right, or similar right with an exercise or conversion privilege at a price related to an equity security, or similar securities with a value derived from the value of an equity security." 17 C.F.R. § 240.16a-1. However, "rights with an exercise or conversion privilege at a price that is not fixed" are expressly excluded from the definition of a derivative security. 17 C.F.R. § 240.16a-1(c)(6). Further,

> the exercise of a derivative security, much like the conversion of a convertible security, essentially changes the form of beneficial ownership from indirect to direct. Since the exercise represents neither the acquisition nor the disposition of a right affording the opportunity to profit, it should not be an event that is matched against another transaction in the equity securities for purposes of Section 16(b) short-swing profit recovery.
>
> The profit that can be realized on short-swing transactions, whether accomplished through derivative securities, the underlying equity security or a combination of both, depends upon the price of the underlying security. While the amount of the profit may vary given factors such as the

> time value of money and volatility of the underlying stock evidenced in the option premium, the exercise does not change the opportunity to realize a profit. As the price of the underlying common stock increases, so does the value of a call option or similar derivative security with a fixed exercise or conversion price related to the common stock.

Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 28, 869, 56 Fed.Reg. 7242, 7249 (Feb. 21, 1991) ("SEC Release").

A derivative security and its underlying equity security are functionally equivalent. *See* SEC Release at 7248. Moreover, "The establishment of or increase in a call equivalent position or liquidation of or decrease in a put equivalent position shall be deemed a purchase of the underlying security for purposes of section 16(b) of the Act. . . . " 17 C.F.R. § 240.16b-6(a). A call equivalent position is "a derivative security position that increases in value as the value of the underlying equity increases, including but not limited to, a long convertible security, a long call option, and a short put option position." 17 C.F.R. § 240.16a-1(b).

In the instant matter, Plaintiff argues that "Bessemer did not own a derivative security in 1999, because the conversion price was not yet fixed, and convertible securities with conversion prices that are not fixed are specifically excluded from the definition of derivative securities. However, once the conversion price became fixed, the Preferred Stock became a derivative security. . . . " (Pl. Mem Supp. Mot. Summ. J. at 11-12) (emphasis in original). Therefore, Plaintiff contends that the IPO provided

Bessemer with a derivative security as of that date, and established a call equivalent position.

Plaintiff's argument is unavailing. Before December 23, 2002, Bessemer's Preferred Stock had its own independent value. It did not derive its value from any then existing VistaCare common stock. Before the IPO Bessemer held non-derivative Preferred Stock. After the IPO, Bessemer's Preferred Stock became Common Stock. Thus, Bessemer no longer held Preferred Stock, but now held Common Stock equal to its prior Preferred Stock holdings. Consequently, when the conversion occurred on December 23, 2002, no derivative or call equivalent position was established.

The "purchase" in the instant matter occurred at the time Bessemer contracted, by signing the Stock Purchase Agreement in 1995, to acquire VistaCare Preferred Stock. That is when Bessemer's rights and obligations became fixed and irrevocable. *See T-bar Inc. v. Chatterjee*, 693 F. Supp. 1, 5-6 (S.D.N.Y. 1988) (defining a purchase as "when the purchaser 'had incurred an irrevocable liability to take and pay for the stock and his rights and obligations have become fixed."); *Prager v. Sylvestri*, 449 F. Supp. 425, 432-33 (S.D.N.Y. 1978) (stating that a purchase is made when the "investor becomes irrevocably committed to the transaction and, in addition, no longer has control over the transaction in any way that could be turned to a speculative advantage by the investor."); *Blau v. Ogsbury*, 210 F.2d 426, 427 (2d Cir. 1954) (stating that purchase occurred when there is "an irrevocable liability to take and pay for the stock").

In 1999, Bessemer re-negotiated the nature of its holdings from Preferred Stock to Common Stock. While

the price of Common Stock was not yet fixed, the conversion ratio negotiated was set to ensure that when the IPO took place the value of the Common Stock would equal the current value of Bessemer's Preferred Stock. Bessemer had no control over the board or management of VistaCare, and thus could not alter the conversion rate previously established in 1999. Further, neither Bessemer, nor any of its partners, officers or agents, had any control over the board or management of VistaCare concerning the timing, form or occurrence of the IPO or the Secondary Offering. In fact, Bessemer urged that the Secondary Offering be delayed, but VistaCare refused. The fact that Bessemer realized a profit from the sale of its Common Stock in 2003 is of no consequence here. There is no indication that Bessemer knew in 1999 the actual date of the IPO, and thus when their Preferred Stock would convert to Common Stock. Even if Bessemer was aware in 1999 the eventual date of the IPO, Section 16(b) "does not strip the insider of all advantage. He may increase or decrease his holdings according to the dictates of his special knowledge. It is only the short-swing transaction which must yield profits to the company alone." *Roberts v. Eaton*, 212 F.2d 82, 85 (2d Cir. 1954).

Moreover, the Second Circuit has found problematic and rejected the argument, implicitly advanced here by Plaintiff, that "one can, as a matter of language, describe the conversion of a company's preferred stock into an equivalent amount of common stock as . . . an 'acquisition' or 'purchase' of another. . . . " *Blau v. Lamb*, 363 F.2d 507, 517 (2d Cir. 1966); *see also Occidental Petroleum Corp. v. Mukamal*, 450 F.2d 157, 162 (2d Cir. 1971) aff'd 411 U.S. 582, 590-91, 36 L. Ed. 2d 503, 93 S. Ct. 1736 (1973) (discussing dictum in *Park & Tilford, Inc. v. Schulte*, 160 F.2d 984 (2d Cir.

1947)). The Second Circuit has stated that putting aside the intimations in Park & Tilford, "in deciding whether a certain transaction is a Section 16(b) 'purchase' or a 'sale' it is relevant to first consider whether the transaction in any way makes possible the unfair insider trading that Section 16(b) was designed to prevent." Lamb, 363 F.2d at 518.

In *Roberts v. Eaton*, 119 F.Supp. 362 (S.D.N.Y. 1953), insiders owned over 45 percent of their company's single class of common stock which was reclassified into a new class of preferred and a new class of common stock. Within six months of the reclassification, the insiders sold their new securities at a profit. In finding that there was no purchase for section 16(b) liability, the District Court stated that "the defendants had owned their stock for several years. The sale cannot possibly come within the provisions of Section 16(b) unless it can be found that they 'purchased' their holdings anew upon reclassification." *Id.* at 365. The District Court further stated that the "corporate shareholders acquired no additional interest in the corporation as a result of the reclassification. It was merely a division of their existing interest. Each stockholder retained what he had held, all the while, in the same proportion, but in a somewhat different form." *Id.* In affirming the District Court's holding, the Second Circuit reasoned that the "cumulative effect" of different factors rendered the reclassification of the securities as not speculative abuse and therefore was not a purchase under Section 16(b). *See Roberts v. Eaton*, 212 F.2d 82, 85-86 (2d Cir. 1954) (cited in *Lamb*, 363 F.2d at 518) (stating that additional factors included the fact that defendants' interests continued in the same company and proportionally unchanged, other factors included the fact that "time consuming ratification by the stockholders was required, and that the acquisition and proposed sale,

was fully disclosed."). In the case at bar, and using the standard articulated in Lamb, none of the possible unfair trading activities that Section 16(b) was designed to prevent is present. Therefore, Plaintiff's contention that the conversion price became fixed on the date of the IPO, and thus that is when Bessemer purchased it's Common Stock, is therefore without merit and must be rejected.

CONCLUSION

Plaintiff's motion for summary judgment is DENIED. Defendants' motion for summary judgment is GRANTED.[6] This action is dismissed in its entirety.

Dated: New York, New York

August 26, 2005

SO ORDERED:

GEORGE B. DANIELS

United States District Judge

[6] Bessemer argues that the complaint should be dismissed because under Rule 16b-7 reclassifications are exempt from Section 16(b) liability, *see* 17 C.F.R. § 240.16b-7, or in the alternative, the reclassification in question was an "unorthodox transaction" that presented none of the dangers that Section 16(b) was intended to address. Plaintiff counters that Rule 16b-7 is inapplicable and that Bessemer's stock conversion is not within the ambit of the "forced" or unorthodox transaction exception. Because the Court has determined that there is no Section 16(b) liability in the instant matter, it need not resolve whether or not the transactions at issue are otherwise exempted from Section 16(b) liability.

United States Court of Appeals
FOR THE
SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, Foley Square, in the City of New York, on the 19th day of April, two thousand six,

Present:

Hon. Joseph M. McLaughlin,
Hon. Jose A. Cabranes,
Circuit Judges,
Hon. John Gleeson,
District Judge.*

Marc Bruh,
Plaintiff-Counter-Defendant-Appellant,

v.

Bessemer Venture Partners III L.P.,
Defendant-Counterclaimant-Appellee,

Vistacare, Inc.,
Defendant.

Docket No.[s]:
05-5271-cv

(Filed Apr. 19, 2006)

Treating the Securities and Exchange Commission's letters of February 6, 2006 and March 24, 2006 as motions for leave to file an amicus brief out of time, we hereby GRANT the motion and request briefing from the SEC by no later than Friday, May 12, 2006 to address the following questions:

(1) whether the parties' establishment of a conversion agreement in 1999 constituted a "purchase"

within the meaning of Section 16(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78p(b);

(2) whether the conversion of preferred stock into common stock was a "reclassification" within the meaning of SEC Rule 16b-7, 17 C.F.R. 240.16b-7; and

(3) whether recent amendments to Rule 16b-7 are permissibly retroactive.

FOR THE COURT:
Roseann B. MacKechnie, Clerk

By: /s/ Lucille Carr

*The Honorable John Gleeson, United States District Judge for the Eastern District of New York, sitting by designation.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 02-1698

MARK LEVY,

Appellant

v.

STERLING HOLDING COMPANY, LLC.; NATIONAL SEMICONDUCTOR CORPORATION; FAIRCHILD SEMICONDUCTOR INTERNATIONAL, INC.

On Appeal from the United States District Court
for the District of Delaware
(D.C. Civ. No. 00-00994)

Before: BECKER, *Chief Judge*, SLOVITER, SCIRICA, NYGAARD, ALITO, MCKEE, RENDELL, FUENTES, SMITH, GREENBERG, and MICHEL,* *Circuit Judges*

ORDER

The motion of the Securities and Exchange Commission to file an amicus curiae brief is granted and the brief received by the Clerk of this court on February 28, 2003, is

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* Honorable Paul R. Michel, United States Circuit Judge for the Federal Circuit, sitting by designation.

accepted as that brief. The appellant may serve and file an answering brief to the SEC brief within ten days.

BY THE COURT,

/s/ [Illegible]
Circuit Judge

DATED: MAR 31 2000

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 02-1698

MARK LEVY,

Appellant

v.

STERLING HOLDING COMPANY, LLC.; NATIONAL SEMICONDUCTOR CORPORATION; FAIRCHILD SEMICONDUCTOR INTERNATIONAL, INC.

On Appeal from the United States District Court
for the District of Delaware
(D.C. Civ. No. 00-00994)

SUR PETITION FOR REHEARING

BEFORE: BECKER, *Chief Judge*, SLOVITER, SCIRICA, NYGAARD, ALITO, MCKEE, RENDELL, AMBRO, FUENTES, SMITH, GREENBERG, and MICHEL,* *Circuit Judges*

The petition for rehearing filed by appellees, Sterling Holding Company, LLC and National Semiconductor

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* Honorable Paul R. Michel, Judge for the United States Court of Appeals for the Federal Circuit, sitting by designation.

Corporation, in the above captioned matter having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the court in regular active service, and a majority of the judges who concurred in the decision not having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court en banc, the petition for rehearing is denied. Judge Greenberg's and Judge Michel's votes respectively are limited to denying and granting rehearing before the original panel. Chief Judge Becker, Judge Ambro, and Judge Smith would grant rehearing before the full court. Judge Michel would grant rehearing before the original panel.

BY THE COURT:

/s/ [Illegible]
Circuit Judge

DATED: APR 30 2003

1934 ACT RULES

17 C.F.R. § 240.16b-7 (1991) Mergers, reclassifications, and consolidations.

(a) The following transactions shall be exempt from the provisions of section 16(b) of the Act:

(1) The acquisition of a security of a company, pursuant to a merger or consolidation, in exchange for a security of a company which, prior to the merger or consolidation, owned 85 percent or more of either

(i) The equity securities of all other companies involved in the merger or consolidation, or; in the case of a consolidation, the resulting company; or

(ii) The combined assets of all the companies involved in the merger or consolidation, computed according to their book values prior to the merger or consolidation as determined by reference to their most recent available financial statements for a 12 month period prior to the merger or consolidation, or such shorter time as the company has been in existence.

(2) The disposition of a security, pursuant to a merger or consolidation, of a company which, prior to the merger or consolidation, owned 85 percent or more of either

(i) The equity securities of all other companies involved in the merger or consolidation or; in the case of a consolidation, the resulting company; or

(ii) The combined assets of all the companies undergoing merger or consolidation, computed according to their book values prior to the merger or consolidation as determined by reference to their most recent available financial statements for a 12 month period prior to the merger or consolidation.

(b) A merger within the meaning of this section shall include the sale or purchase of substantially all the assets of one company by another in exchange for equity securities which are then distributed to the security holders of the company that sold its assets.

(c) Notwithstanding the foregoing, if a person subject to section 16 of the Act makes any non-exempt purchase of a security in any company involved in the merger or consolidation and any non-exempt sale of a security in any company involved in the merger or consolidation within any period of less than six months during which the merger or consolidation took place, the exemption provided by this Rule shall be unavailable to the extent of such purchase and sale.

1934 ACT RULES

17 C.F.R. § 240.16b-7 (2006) Mergers, reclassifications, and consolidations.

(a) The following transactions shall be exempt from the provisions of section 16(b) of the Act:

(1) The acquisition of a security of a company, pursuant to a merger, reclassification or consolidation, in exchange for a security of a company that before the merger, reclassification or consolidation, owned 85 percent or more of either:

(i) The equity securities of all other companies involved in the merger, reclassification or consolidation, or in the case of a consolidation, the resulting company; or

(ii) The combined assets of all the companies involved in the merger, reclassification or consolidation, computed according to their book values before the merger, reclassification or consolidation as determined by reference to their most recent available financial statements for a 12 month period before the merger, reclassification or consolidation, or such shorter time as the company has been in existence.

(2) The disposition of a security, pursuant to a merger, reclassification or consolidation, of a company that before the merger, reclassification or consolidation, owned 85 percent or more of either:

(i) The equity securities of all other companies involved in the merger, reclassification or consolidation or, in the case of a consolidation, the resulting company; or

(ii) The combined assets of all the companies undergoing merger, reclassification or consolidation, computed according to their book values before the merger, reclassification or consolidation as determined by reference to their most recent available financial statements for a 12 month period before the merger, reclassification or consolidation.

(b) A merger within the meaning of this section shall include the sale or purchase of substantially all the assets of one company by another in exchange for equity securities which are then distributed to the security holders of the company that sold its assets.

(c) The exemption provided by this section applies to any securities transaction that satisfies the conditions specified in this section and is not conditioned on the transaction satisfying any other conditions.

(d) Notwithstanding the foregoing, if a person subject to section 16 of the Act makes any non-exempt purchase of a security in any company involved in the merger, reclassification or consolidation and any non-exempt sale of a security in any company involved in the merger, reclassification or consolidation within any period of less than six months during which the merger, reclassification or consolidation took place, the exemption provided by this section shall be unavailable to the extent of such purchase and sale.

15 U.S.C. § 78p. Directors, officers, and principal stockholders

* * *

(b) Profits from purchase and sale of security within six months. For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) or a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 USCS § 78c note]) involving any such equity security within any period of less than six months, unless such security or security-based swap agreement was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security or security-based swap agreement purchased or of not repurchasing the security or security-based swap agreement sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and

sale, or the sale and purchase, of the security or security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 USCS § 78c note]) involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

* * *